

In the  
**United States Circuit Court**  
**of Appeals**  
**For the Ninth Circuit 9**

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G. M. STANDIFER CONSTRUCTION CORPORATION  
*Petitioner and Appellant*

*v.*

COMMISSIONER OF INTERNAL REVENUE  
*Respondent and Appellee*

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**Brief of Petitioner and Appellant**

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Upon Petition for Review of Decision of the  
United States Board of Tax Appeals

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FILED

MAR 25 1935

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**STATEMENT OF THE CASE**

Appellant, hereinafter referred to as the taxpayer, has filed in this Court its petition for the review of the decision of the United States Board of Tax Appeals entered June 7, 1934, in favor of the appellee, the Commissioner of Internal Revenue, hereinafter called the Commissioner, and against the taxpayer.

By a notice of deficiency dated November 1, 1930 (Transcript p. 8), the Commissioner notified the taxpayer of a deficiency of \$8,605.20 in its income tax

for the year 1928. The taxpayer appealed from the Commissioner's determination of deficiency to the United States Board of Tax Appeals. Upon the hearing before the United States Board of Tax Appeals the deficiency asserted by the Commissioner was re-determined in the sum of \$4,999.57 (Transcript p. 31).

The case is brought to this Court by a petition for review filed September 5, 1934 (Transcript pp. 32-38), pursuant to the provisions of Section 1001 of the Revenue Act of 1926 (44 Stat. 9), as amended by Section 603 of the Revenue Act of 1928 (45 Stat. 791) and by Section 1101 of the Revenue Act of 1932 (47 Stat. 169).

The only previous opinion in this case is that of the United States Board of Tax Appeals (Transcript p. 23), which is reported in 30 B. T. A. 184.

### QUESTION PRESENTED

A single question is presented, whether the net loss carried over from 1927 and claimed by the taxpayer as a deduction from its 1928 income is to be reduced by the sum of \$26,951.09, representing wages of employees accrued and deducted from income in 1920 and prior years but unclaimed by the employees, the account not having been adjusted to surplus in 1927 and the statute of limitations on such unclaimed wage items having expired in 1924 and prior years.

## SPECIFICATION OF ERRORS

### I.

The United States Board of Tax Appeals erred in deciding and holding that the taxpayer received income on its filing a certificate of dissolution in 1927, in the amount of \$26,951.09, representing unclaimed wages of employees, in respect of which the statute of limitations expired in 1924 and years prior thereto.

### II.

The Board erred in deciding and holding that the taxpayer's net loss for 1927, to be carried forward as a deduction from the taxpayer's income for 1928, was \$30,046.86, or any sum less than \$68,709.92, as reported by the taxpayer in its 1928 return.

### III.

The Board erred in entering its decision in favor of the Commissioner and against the taxpayer for a deficiency of \$4,999.57 in the taxpayer's income tax for the year 1928.

## THE FACTS

The taxpayer, an Oregon corporation, was engaged in the shipbuilding business from 1917 to 1921. A considerable part of the taxpayer's operations consisted of the building of ships for the United States Shipping Board Emergency Fleet Corporation.



In February, 1920, there was a sharp wage controversy in the taxpayer's plant, culminating in a strike of the employees. After considerable negotiation the strike was settled on the basis of an increased wage which was made retroactive. To the extent of \$26,951.09 these wages were never called for by the employees entitled to them. Substantially all of these unclaimed wages represented wages accrued in 1919 and 1920, only \$75.92 being applicable to the year 1921. All of these unclaimed wage items represented liabilities of the taxpayer accrued in the State of Washington.

The statute of limitations with respect to the taxpayer's liability for payment of these unclaimed wages aggregating \$26,951.09, expired three years after the liabilities were incurred. The liability of the taxpayer for payment of these unclaimed wages expired not later than 1923 with respect to all but \$75.92 of the amount determined by the Board to have represented income to the taxpayer in 1927, and as to the said sum of \$75.92 the statute of limitations expired in 1924.

Pursuant to resolutions of the taxpayer's stockholders and directors adopted July 2, 1927, the taxpayer on August 30, 1927, filed with the Corporation Commissioner of Oregon a certificate of dissolution. Under the Oregon statutes the taxpayer remained in existence for five years after August 30, 1927, the



date of issuance of the Corporation Commissioner's certificate of dissolution, for the purpose of winding up its affairs.

The taxpayer was not liquidated during the year 1927, for on December 31 of that year it had assets aggregating \$190,533.99, consisting of the following:

Cash .....	\$ 7,579.79
Notes receivable .....	5,126.62
Accounts receivable ....	31,827.58
Accounts receivable from stockholders.....	146,000.00

Total assets.....	<u>\$190,533.99</u>
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On December 31, 1927, the taxpayer still carried on its books unclosed liability accounts amounting to \$155,073.15, which included the above mentioned unclaimed wage items aggregating \$26,951.09, as well as a liability carried in a Vouchers Payable account, amounting to \$36,992.05, held by the Board to have been discharged as an obligation of the taxpayer in the year 1924.

There is no dispute regarding the facts involved in this case. The only question is whether under the stipulated facts the taxpayer is to be charged with the receipt of income in 1927, in the amount of the unclaimed wage liability remaining on its books, thus reducing the net loss to be carried forward to 1928, because the taxpayer adopted resolutions of dissolution in the year 1927.

## POINTS RELIED ON BY APPELLANT

## I.

All items of gross income are to be accounted for in respect of the *taxable year in which received or accrued by the taxpayer.*

Sections 212(b) and 232, Revenue Act of 1926;  
Article 22, Regulations 69;

*Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 51 S. Ct. 418, 420;

*Brown v. Commissioner of Internal Revenue*, 63 F. (2d) 66, 68;

Paul and Mertens, Law of Federal Income Taxation, par. 11.03 (Vol. 1, page 481).

## II.

Assuming that a taxpayer receives income as the result of the discharge from liability for an obligation, such income is to be accounted for in the year in which such liability is discharged.

Sections 213(a) and 233(a), Revenue Act of 1926;

*Great Northern Railway Company v. Lynch*, 292 Fed. 903;

*Peabody Coal Co. v. Commissioner*, 18 B. T. A. 1081;

Paul and Mertens, Law of Federal Income Taxation, par. 7.48 (Vol. 1, page 278);

*Chicago, Rock Island and Pacific Ry. Co. v. Commissioner*, 47 F. (2d) 990;

*Charleston and W. C. Ry. Co. v. Burnet, Commissioner*, 9 B. T. A. 105.

## III.

A corporation does not receive income as a result of its dissolution. There having been no change in the liability of the taxpayer for unclaimed wages in the year 1927, as distinguished from prior or subsequent years, the taxpayer received no gross income therefrom in that year.

*Cooper-Brannan Naval Stores Co. v. Commissioner*, 18 B. T. A. 1081.

## ARGUMENT

## I.

All items of gross income are to be accounted for in respect of the *taxable year in which received or accrued by the taxpayer.*

“The concept is fundamental that the law imposes the tax with reference to a fixed period of time. The income tax law is predicated upon annual periods; proving income for a period of years does not prove income for any one year . . . .”

This statement is found in paragraph 11.03 of Paul and Mertens Law of Federal Income Taxation (Volume 1, page 481). It is a clear and concise statement of the rule which must form the basis of a decision in this case. Although there may be some doubt whether the items of unclaimed wages here in dispute ever did become income to the taxpayer, that issue is not involved in this case. The sole

question presented is whether the taxpayer received income *in 1927* because of the failure of employees to call for certain items of wages accrued by the taxpayer on its books of account and deducted on its income tax returns for the years 1919, 1920 and 1921, when such expenses were accrued.

The taxpayer was engaged in the shipbuilding business during the years 1919, 1920 and 1921. It employed hundreds of workmen. Certain of these workmen did not collect all of the wages due them, principally items of increased wages made retroactively effective under settlements of wage disputes. The statute of limitations with respect to these unclaimed wage items expired under statutes of the State of Washington in the years 1922, 1923 and 1924. The liability of the taxpayer for payment of these unclaimed wages expired with the running of the statute of limitations. However, these liabilities when discharged by the running of the statute of limitations were not adjusted to surplus; in fact, no change was made in the taxpayer's books of account.

Upon examination of the taxpayer's returns for the years 1927 and 1928, the Commissioner determined that these unpaid wage items should be treated as income of the taxpayer in the year 1927, and as his reason therefor, stated that the taxpayer was dissolved in that year. The Board upheld the Com-

missioner in his contention. By so doing, the Board disregarded completely the requirements of the revenue acts and regulations issued thereunder, as well as the universal interpretation of such provisions by the courts. The precise question was presented in *Burnet v. Thompson Oil & Gas Co.*, 283 U. S. 301, 51 S. Ct. 418, 420, and the Supreme Court held that only deductions applicable to the taxable year should be allowed. The Court said:

“ . . . The tax is an income tax for 1918, and in the absence of express provision to the contrary, it is not to be supposed that the taxpayer is authorized to deduct from that year's income, depreciation, depletion, business losses or other similar items attributable to other years. The very fact that Congress denied deductions equal to the sustained depletion in the earlier years negatives an intent that they should be allowed in later years, as if for depletion then sustained. The construction adopted by the court below in effect results in including in the taxable year items referable to other years, and is contrary to the theory of a tax for specific years.”

The rule is well stated in *Brown v. Commissioner of Internal Revenue*, 63 F. (2d) 66, 68, recently decided by this Court, in the following language:

“Revenue taxation requires that one who receives a sum of money subject to his disposition should account for the same as income in the year he receives it and not at some indefinite future time of his own selection. . . .”



## II.

**Assuming that a taxpayer receives income as the result of the discharge from liability for an obligation, such income is to be accounted for in the year in which such liability is discharged.**

The "gross income" of a taxpayer is defined by Section 213(a) of the Revenue Act of 1926. As stated above, there is some doubt whether the taxpayer received income in any year under the facts of this case. In order to bring the discharge of the taxpayer from liability for payment of the unclaimed wages within the category of "gross income", as defined by Section 213(a) of the 1926 Act, it must be found that some principle or rule for determining gross income requires such treatment.

It is a well-established principle that the cancellation of indebtedness may result in taxable income. In *Great Northern Railway Company v. Lynch*, 292 Fed. 903, it appeared that certain unpaid obligations of the Railway Company which accrued prior to January 1, 1909, became outlawed in 1910, and were entered on the Company's books as profit received in that year. It was held that the amount of these unpaid obligations was subject to the special excise tax imposed by the Act of August 5, 1909.

The same rule was applied in *Chicago, Rock Island & Pacific Ry. Co. v. Commissioner*, 47 F. (2d) 990, and in *Charleston & W. C. Railway Company v. Bur-*

*net, Commissioner*, 50 F. (2d) 342. It was found in the Chicago, Rock Island & Pacific case that under regulations of the Interstate Commerce Commission the Railway Company had charged to profit and loss the amounts of certain checks and vouchers issued as compensation for services and in payment of loss or damage claims, when such checks and vouchers were not presented for payment within two years from the date of issuance. The Circuit Court of Appeals for the Seventh Circuit held that "as a practical matter" the items became income for the year in which the Company charged them to profit and loss.

In the Charleston case it appeared that certain items of unclaimed wages accrued on the Railway Company's books and deducted as wage expense in the Company's 1921 income tax return, were charged to profit and loss in December, 1924. The Court of Appeals of the District of Columbia, following the decision in the Chicago, Rock Island & Pacific case, held that these unpaid wage claims constituted income to the Railway Company when charged to profit and loss. In this case, as well as in the Chicago, Rock Island & Pacific case, it was expressly stated that if any part of the wages due should be claimed and paid at any subsequent time, deduction could properly be made for any amounts paid. In each case cited above the statute of limitations had



not run when the wage items were included in the income accounts, and these wage items were still enforceable claims against the employer.

In a recent text (Paul and Mertens, Law of Federal Income Taxation, par. 7.48) the authors conclude that:

“Liabilities which do not culminate in payment should enter into the computation of income upon the expiration of the statute of limitations. . . .”

A similar question was presented to the Board of Tax Appeals in *Peabody Coal Company v. Commissioner*, 18 B. T. A. 1081. The taxpayer urged that the Commissioner erred in including the balances of certain reserve accounts in the taxpayer's 1921 income. The Board held that the amount of the reserves should have been included in the taxpayer's income in 1919 or 1920, when the reserves were set up, or in 1922, when the reason for the reserves ceased to exist, but that the amount of the reserves was not income in 1921, as claimed by the Commissioner. The Board said:

“. . . In our opinion the action of the respondent can not be sustained. The unexpended balances in the reserves were either income to the petitioner in 1919, when the contracts with the Peoples Gas Light & Coke Co. and the Central Illinois Public Service Co. expired, or they were income in 1922 when the liabilities for which the reserves were maintained were determined and paid, but they were not income in 1921.

"We are also of the opinion that the respondent erred in including in the petitioner's income for 1921 the amounts remaining in the reserve for subsidence and the reserve for excessive freight. These reserves were set up by the petitioner in the years 1919 and 1920 and no change was made in them in the year 1921. If they were not reserves of the kind that are recognized as proper deductions from income by the several revenue acts, they should have been restored to the petitioner's income in the years in which they were made. If they are reserves the net additions to which are allowable as deductions from income, then the unexpended balances became income to the petitioner in the year in which the reason for which they were created ceased to exist, which was in 1922. The amount of the reserves in question should be eliminated from the petitioner's income for 1921."

### III.

A corporation does not receive income as a result of its dissolution. There having been no change in the liability of the taxpayer for unclaimed wages in the year 1927, as distinguished from prior or subsequent years, the taxpayer received no income therefrom in that year.

In the case now before this Court no act or transaction took place in the year 1927 which under any theory could be held to have given rise to income to the taxpayer. The statute of limitations with respect to all of the unclaimed wages in question expired in 1922 and 1923, except as to \$75.92, with respect to which the statute expired in 1924. Under the rule

stated by Paul and Mertens, *supra*, the items of unclaimed wages became income to the taxpayer when the liabilities were discharged by the running of the statute of limitations; if so, the income was received in 1924 and prior years, and not in 1927.

Under the Oregon law the mere dissolution of a corporation does not affect the liabilities of the dissolved corporation. Section 6875, Oregon Laws, as amended by Chapter 340, General Laws of Oregon, 1927, provided that all dissolved corporations continue to exist as bodies corporate for a period of five years after dissolution, for the purpose of winding up their affairs. The taxpayer, having filed its certificate of dissolution in 1927, continued in existence for five years thereafter, and during all of such five-year period the taxpayer was as much liable (but no more so) for the items of unclaimed wages in question as in 1927 or any other year after the running of the statute of limitations.

A dissolved corporation maintaining its corporate existence after dissolution for the purpose of liquidating and winding up its corporate affairs, is treated for income tax purposes as any other corporation. It is required to file income tax returns, and must report all taxable income and pay income tax thereon. With the single exception of the Board's decision in this case, the dissolution of a corporation has never been held to compel the closing of liability or other accounts into profit and loss or surplus.

The Commissioner is not authorized arbitrarily to select the year in which a taxpayer receives income from any given transaction. The Commissioner has in numberless cases held taxpayers to meticulous proof of the propriety of deductions for bad debts and investment losses. A taxpayer has never been permitted to select any one of a number of years to charge off and deduct losses which occurred during the period. Likewise, a taxpayer has not been required to report income as received in one year when the income in question was received in some other year.

The precise question was before the Board of Tax Appeals in *Cooper-Brannan Naval Stores Co. v. Commissioner*, 9 B. T. A. 105. In that case the Board found in part as follows:

“Prior to 1920, petitioner kept a single entry set of books and, no balances ever having been made, errors in the accounts were not detected. In June, 1920, petitioner employed a public accountant to install a double-entry set of books as of January 1, 1920. The accountant made up from the old books a forced balance sheet as of December 31, 1919, whereon he entered ‘accounts receivable’ totaling \$5,649.49 and ‘accounts payable’ totaling \$5,736.40. It was discovered subsequently during 1920 that payment of \$97.34 of said accounts receivable had in fact been received by petitioner prior to January 1, 1920, and that \$2,218.61 of said accounts payable had actually been paid by petitioner prior to that date, but had not been properly entered on the old set of



books. As the erroneous entries were discovered the items were transferred to a suspense account, in order to correct petitioner's 1920 accounts. At the end of the year 1920 the suspense account was closed out and \$2,121.27 was added to surplus as of January 1, 1920, in closing the books for the calendar year 1920. The respondent increased petitioner's gross income for 1920 by the amount of \$2,121.27 as a result of the above corrections made on petitioner's books on the ground that the said amount represented an accumulation of income over prior years which was not reported in such prior years."

The Board held that the accumulated items did not constitute income for the year 1920. Its conclusion was stated as follows:

"The amount of \$2,121.27 which respondent added to gross income for 1920 for the reason that it represented an accumulation of income for prior years, but not reported in such prior years, is certainly not income for the year 1920 when it was income for prior years and therefore should be eliminated from petitioner's gross income for the year 1920."

At the close of the year 1927, the taxpayer's books of account disclosed assets substantially greater than its existing liabilities, including the liability for unclaimed wages here in question which expired in 1924 and prior years on the running of the statute of limitations. The Commissioner should not be permitted to distort the taxpayer's income by including therein arbitrarily in any year of the

Commissioner's selection, items which should properly be included in income in another year.

It is submitted that if the items of unclaimed wages became income to the taxpayer at any time, such items became income when the taxpayer was discharged from liability therefor by the running of the statute of limitations.

Respectfully submitted,

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